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RUEHDA/AMCONSUL ADANA 3226  
RUEHBS/USEU BRUSSELS

UNCLAS ANKARA 001639

SIPDIS

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [TU](#)

SUBJECT: TURKISH GDP GROWTH SLOWED SHARPLY IN SECOND QUARTER

¶1. Summary: TurkStat data released on September 10 showed Turkey's GDP grew only 1.9% (YOY) in the second quarter, far below market forecasts of 3.7% and down sharply from 6.7% growth in the first quarter. While first half growth was still a respectable 4.2%, the sharp slowdown from quarter to quarter has some market analysts already lowering their 2008 forecasts to 3.0%. The data showed a broad-based slowdown in domestic demand and investment, in both the public and private sectors. Markets reacted negatively, with Turkish equities falling about 5% on September 10 and 11, and the Turkish lira depreciating about 3% against the dollar. This data will add to public pressure on the GOT to move forward on its economic agenda, but two of the key factors affecting growth for the rest of year are outside of Turkey's control: the extent of the slowdown in the Eurozone and the UK (Turkey's major export markets), and whether foreign banks reduce their FX lending to Turkish companies. End Summary

¶2. The Turkish economy grew just 1.9% (YOY) in the second quarter, the slowest rate of expansion since 2002, and significantly below the 3.7% consensus market forecast. This is a marked deceleration from growth in the first quarter, when GDP grew 6.7% (YOY). While GDP growth in the first half was still a respectable 4.2% YOY, the sharp quarter-on-quarter slowdown has forced investors and businesses to review and, in some cases, revise downward their 2008 growth projections, which were at 4.0% before this data was released. Some analysts already have dropped their forecasts to 3.0%, while those who are sticking to 4.0% say they see downside risks, particularly from the economic slowdown in the European Union.

¶3. Market reaction was sharply negative following the data release on September 10. Turkish equity markets fell over 5% on September 10 and 11, while the Turkish lira depreciated about 3.0% against the dollar (the lira also was driven down by negative global developments).

¶4. The TurkStat data showed across the board weakness in domestic demand. Investment growth decreased 6.8% from the first quarter, while household demand decreased 2.1% and the agriculture sector was down 3.5%. Cuts in non-interest government expenditures resulted in a 3.7% contraction in consumption in the second quarter, and a 16.8% drop in public sector investment expenditures.

¶5. The data also showed that private sector has scaled back investment and consumption. Growth in consumption expenditures dropped from 7.6% in the first quarter to 2.8%, while investment expenditure growth fell from 14% to just 0.6%. Industrial output growth of 2.8% YOY was the slowest pace of manufacturing growth since 2002.

¶6. Faik Oztrak, a former Treasury undersecretary and now a CHP deputy, invited the GOT to take immediate measures to avoid a possible recession and given Turkey's high borrowing needs. Tanil Kucuk, president of the Istanbul Chamber of Industry, urged the GOT to announce an action plan combined with a new economic program. Nurattin Ozdemir, President of the Ankara Chamber of Industry said companies are in a difficult situation due to lack of domestic demand. Ercan Kumcu, a former Central Bank vice-governor and now a

daily columnist, noted that the GDP slowdown is hard to explain given other recent economic data, especially trade data (exports rose 41% in July).

[17](#). Comment: While this data will add to public pressure on the GOT to move forward on its economic agenda, two of the key factors affecting growth for the rest of year are outside of Turkey's control: the extent of the slowdown in the Eurozone and the UK (Turkey's major export markets), and whether foreign banks, particularly in Europe, reduce their FX lending to Turkish companies, which has been a popular source of low-interest finance.

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